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## A globalisation challenge: Preventing a clash between the middle classes of the developed and emerging economies

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## **A globalisation challenge: preventing a clash between the middle classes of the developed and emerging economies**

*Andrés Ortega, Miguel Otero-Iglesias, and Federico Steinberg*

### **Abstract**

Tension is growing between the interests of the middle classes that are in decline in the mature economies and the rising ones in emerging markets. The aim of the public policies proposed in this paper is to impede such a clash by not threatening de-globalisation, avoiding protectionism, fostering inclusive technological innovation, compensating the losers of globalisation in developed economies and reassuring the winners in emerging economies. It argues that the G20 concept of ‘inclusive growth’ must overcome the challenges that come with reduced inequalities between countries, growing inequality within countries and the disruptive impact that accompanies technological innovation.

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## **The Challenge**

The combination at the same time of some of the economic, political and social effects of the Great Recession/Eurozone crisis (2008-13) and an unequal rate of recovery between and within countries, along with the rapid introduction of new task-automation technology, can give rise to a new type of divergence, or decoupling (Snower, 2017), between and within mature and emergent economies. This could have an impact on the political stability of regimes through a growing sense of rage in the middle and lower-middle classes, which have seen their incomes and position decline in relative terms in the process (and this is especially the case in the US and Western Europe). The feeling of indignation has already begun to translate into electoral results and policies. *Brexit*, Trump and the strengthening of the far-right spring to mind. Therefore, building a more inclusive and legitimate globalisation should be at the highest level of the G20's priorities.

The evidence shows that globalisation has contributed to lift billions of people out of poverty around the world, especially in Asia, and more specifically in India and China (Spence, 2012; United Nations, 2015). The process has not occurred as a matter of course. It was man-made, and so can equally be reversed by human action. Therefore, a slower pace, or even reversal, of globalisation could deliver a negative shock to the developing world and for parts of some developed countries. So, from a normative perspective, the advancement of globalisation should be maintained at a prudent pace.

A number of studies (Milanović, 2016; Milanović & Roemer, 2016; World Bank, 2016; ILO, 2016) have quantified that inequality has fallen at a global level (although much less if China and the countries of the former Soviet Union are excluded) and that a global middle class has seen the largest income increase in the 1988-2008 period. According to Milanović, global inequality has decreased from 69 Gini points in 1988 to 64 Gini points in 2011. However, in the advanced economies inequality has increased, and the middle and lower-middle classes (whose income is between US\$15.000 and US\$35.000 PPA) are in relative decline, due in part to globalisation, the effect of the Great Recession and the impact of the skill-substituting technological and digital revolution we are witnessing. Moreover, the economic recovery that the global economy (and especially the advanced countries) is experiencing since 2013 seems to be too weak to ensure that the losers from the aftermath of the global financial crises and those most adversely hit by the technological revolution can regain their trust in the future. At the same time, in the emerging countries there is a growing risk that the introduction of labour-saving technologies can reduce the trend of employment creation that has been driving prosperity in the last decades. Therefore, the fear of secular stagnation in advanced countries (Teulings & Baldwin, 2014) and the slow growth in total factor productivity may force central banks to maintain expansionary monetary policies to sustain growth extensively. And there is a growing fear that these expansionary policies could also be fuelling inequality because they disproportionately benefit citizens who own assets –and tend to belong to the upper-middle classes–.

From a public policy perspective, in recent years the most cited and commented chart on the effects of globalisation has been Milanović's so-called 'Elephant Curve', which shows what segments of the global population saw a rise in real incomes from 1988 to 2008, thus reflecting

a general growth of the middle classes and leading to the creation of a global middle class. His first calculations stopped in 2008 (he later provided new data up to 2012) just when the Great Recession started. It is very likely that the crisis has only increased this trend and has put even more pressure on the middle classes in the US and Europe, which suffered to a greater extent the effects of the global financial and euro crises.

In a report appropriately titled ‘Poorer than their parents?’, McKinsey (Dobbs *et al.*, 2016) argues that real incomes in advanced economies between 2005 and 2014 stagnated or fell for 65%-70% of households, accounting for more than 540 million people. The report reaches the deeply disturbing conclusion that even a return to strong GDP growth may not eliminate the flat or falling trend as demographic (older people with lower pensions) and labour (elimination of jobs through technology) factors weigh on incomes.

The International Labour Organisation, in some of its studies, has also argued for the need to tackle these issues from a middle-classes perspective (ILO, 2016; Vaughan-Whitehead *et al.*, 2016). There is also the problem of the self-perception of the declining middle class, as a Gallup (Newport, 2016) poll showed for the US, a tendency that is replicated in some other countries. At any rate, perceptions weigh as heavily as reality when it comes to the political impact of the major issue of the loss of social status in the West. As Rodrik (2016), one of the first to draw attention to this contentious issue, writes, ‘the frustrations of the middle and lower classes today are rooted in the perception that political elites have placed the priorities of the global economy ahead of domestic needs. Addressing the discontent will require that this perception is reversed’. Historically, societies that have started to decline can make decisions that accelerate the process. See the autocratic and inward-looking phases in the histories of Spain and China, to give just two examples. Thus, protectionist reactions might go against the interests of the emerging economies, but also of the developed ones.

There is a great debate on whether this time the technological revolution will destroy more jobs than it creates (Ortega, 2016; Otero, 2017; Gregory *et al.*, 2016; Autor, 2015; Frey & Osborne, 2016; among many others). Even if it creates many new ones, as the recent work of Acemoglu (2017) suggests, workers losing their jobs to technology will not get any new jobs through technology for lack of skills and adaptation, suffering a double blow. Because they have low skill levels, they are losing their jobs due to the adoption of new technology, and while this technology is creating new jobs in new sectors, they have no access to them because they do not have the skills to operate the computers or machines. Or they have to get jobs with lower wages. Thus, there is a problem of transition from the present system to a future one that is still not clear. The transition, technological but also social, will in the short and medium terms generate more inequality even if the prices of products and services drop and are more accessible to the lower layers of society.

Contrary to what is sometimes believed, the trend seems to be a danger particularly for developing countries. The ‘share of occupations that could experience significant automation is actually higher in developing countries than in more advanced ones, where many of these jobs have already disappeared’, and this concerns around two thirds of all jobs according to a report by UNCTAD (2016). Similarly, an analysis by Frey & Osborne (2015) foresees a greater impact on developing countries than on mature economies. For instance, they expect computerisation to

destroy perhaps 57% of current jobs in the OCDE area and 47% in the US, but as many as 77% in China and 69% in India, in gross terms, although in net terms the balance might be less given the creation of ‘new jobs’ (that are as yet unquantifiable). In other words, despite the gloomy talk, the richer and more advanced countries are more resilient but, increasingly, more of the jobs affected are those done by the middle classes, not only by the working classes. This is politically worrying even if a new digital middle class emerges in most of economies.

However, other studies challenge these assumptions. For instance, in the case of Africa, it is argued that its economies are now well positioned to take advantage of the numerous opportunities that the 4th industrial revolution presents. The feeling is that the digital revolution can actually drive inclusive growth and prosperity, in comparison with previous industrial revolutions. As Obado (2017) puts it, in the 1st Industrial revolution Africa was dealing with slavery, the 2nd coincided with colonisation and in the 3rd Africa was focused on decolonisation and nation-building. The Internet, however, could add US\$300 billion to Africa’s GDP by 2025 if it continues to grow at the same pace as mobile telephony did, according to McKinsey (Manyika *et al.*, 2013). But to go digital does not imply the same kind of consequences as automation, 3D printing and other technologies. And there is a need to invest more in R&D. Today, Africa spends only 0.1% of its GDP on R&D, with more advanced countries in technology such as Kenya spending only 1%, compared with 3%-4% in the most developed economies.

Providing an answer to this huge challenge will determine the image and profile of globalisation and the G20, its main governance body, which are increasingly becoming the targets of anti-globalisation movements and sentiment, especially in the US and Europe, where protectionist voices are getting louder or even hold power as is the case with US President Donald Trump.

Faced with this new reality, liberal-minded policymakers need to ensure that a protectionist backlash in advanced countries is avoided and that both advanced and emerging members of the G20 implement policies to reduce the negative impact of automation in employment, both in advanced and emerging economies. Ultimately, as the OECD (2016) has concluded, ‘trade protectionism shelters some jobs, but worsens prospects and lowers well-being for many others. In many OECD countries, more than 25% of jobs depend on foreign demand’.

This general policy orientation of saving globalisation from the free-market globalisers, which have for too long neglected the negative effects of this human phenomenon, could come under the heading of globalised ‘technological justice’ (Ortega & Andrés, 2017). However, authors like Rodrik (2017) have been critical of the capacity of current political regimes and policies to compensate the losers from globalisation and increase the system’s legitimacy. He advocates a radical change in discourse and policies capable of building a more balanced global economy.

Fortunately, policy orientation is starting to go in that direction. In Stockholm in November 2017 the EU adopted a European Pillar of Social Rights (European Commission, 2017a). Even though the proposal is non-binding, it aims at establishing equal opportunities and access to the labour market, fair working conditions and social protection and inclusion. On the external front, the EU also approved a framework for D4D (Digital4Development) as part of its development policy, with an immediate focus on Africa, which could inspire actions at a global level (European Commission, 2017b). The aim is to develop digital infrastructure, promote e-

governance and digital skills, strengthen the digital economy and foster start-up ecosystems, including funding opportunities for micro, small and medium sized enterprises. Even though the private sector plays a critical role in pursuing these aims, the EU has created an investment window for the purposes within the European Fund for Sustainable Development. This is a good example of public-private cooperation.

Both initiatives show the growing concern of European elites that it is necessary to tackle the rising economic and technological inequality in the richer and poorer countries simultaneously.

## **Policy proposals**

### *Avoid protectionism and balance globalisation*

We believe that world leaders, especially the G20 forum, should reinforce the World Trade Organisation's (WTO) rules in trade disputes in order to avoid a regression in trade and cross-border investment practices and the rise of US-led bilateralism. There is a justified concern that during the Trump Administration, the US might drop out of the WTO. This would be a heavy blow to the liberal world order. But, even if the US remains within the institution, it is already weakening it by blocking the appointments for some of the vacancies in the Dispute Settlement Mechanism. This can seriously undermine the WTO's capacity to perform its duties.

It is also important to avoid breaking the global value chains that have both brought down the cost of products and services and have led to the transfer of technology and know-how to developing economies (Baldwin, 2017). This requires preventing the collapse of current free-trade agreements such as NAFTA. However, at the same time, the causes and effects of outsourcing and the impact of new technologies must be acknowledged and addressed. Certain countries, such as Finland and the Netherlands, have already initiated pilot projects around a universal basic income. This type of experiments should be further promoted.

The G20 also needs to steadily level the playing field in the world economy by reducing social dumping. This cannot be done overnight as different social protection systems have been at the root of the growth of many economies from the start. But progress should be made towards fairer competition and the obligation to comply with agreed minimum standards. Emerging countries such as China, who have climbed the value-added ladder in the past decade and have started to invest massively around the world, including in the West, should accept that reciprocity in market access is key to maintain an open world economy.

The weakening of labour in general and of trade unions in particular –due to global competition, the larger weight of capital (including profits) over labour incomes, decisions taken at the level of the firm and new forms of work that do not produce stable employment (such as the growth in self-employed freelancers)– has played a role in the backlash against globalisation in developed countries (Rodrik 2017). Therefore, there should be more thought on renewed forms of organised labour –using the communication tools of new technologies also– to increase its negotiating profile and bargaining power.

In developing countries, labour organisations have often been suppressed, but they could yet be a factor for progress. In particular, given that self-employment and part-time employment are expected to increase, it would be necessary to find ways for these workers (who are not unionised) to participate in the wage-bargaining process. A coordinated increase in minimum wages across countries should also be considered. This could start in the EU. As the ECB's Mario Draghi has indicated, an increase in wages would help to fight the now almost structural low inflation that we are experiencing and thus help to normalise monetary policy again in order to have more elbow room in the next recession. Moreover, it could reduce inequality and contribute to the growth of aggregate demand through consumption, thus increasing economic growth.

*Compensate the losers in developed and help developing countries*

The reality is that if there is no compensation and empowerment for workers, the vote for radical or populist alternatives could increase and favour protectionism and de-globalisation in the North-Atlantic basin. Thus, for the major losers of globalisation or those displaced by automation, income-guarantee schemes should be explored. Even if only for a transitional period and not as a way of organising a society in the long term, since it is still not known what the ultimate implications of technological change will be.

The EU used the so-called 'cohesion funds' to compensate the efforts in which some peripheral economies had to engage to adapt to the creation of the single market in the 1980s and 90s. Some kind of global cohesion fund could be set up in order to offset the losses suffered by the sections of the most negatively-affected societies, whose reward has essentially 'only' been access to cheaper products, including technological ones. This fund could be financed by new taxes, as with financial transactions, green-house gas emissions or air travel, precisely the type of activities undertaken by the global elites, who are precisely those that benefit the most from the global public good that is globalisation.

*Permanent education*

An overhaul of the education system is necessary to empower and recycle the skills of individuals throughout their working lives. This should be done through a public-private compact in each country, taking as a good example the German system of dual apprenticeship, and using the new tools enabled by digital technology. There should also be more exchanges of students worldwide. A global Erasmus programme could bring the world closer together. This has already been treated in the G20's Labour & Employment Ministerial Declaration (G20, 2014) and other documents, which now need to be put into practice.

The professional empowerment of women is also a necessary policy for these purposes and their education and training is essential.

*Reassure the emerging economies*

Although it is important to address the disruptions caused by globalisation to the lower-skilled lower and middle classes of the developing economies, it is also crucial to allow emerging economies to continue growing not only through the expansion of their own internal demand but also through exports, guaranteeing that the cycle of globalisation continues, with corrections and with sustainability. Here, again, a greener economy will be needed both in developing countries

(if consumption patterns in China and India follow those of the West in the last decades, the world will become uninhabitable) but also in developed nations, which need to share some of the technology they possess in order to reduce CO2 emissions worldwide.

Advanced economies, especially in Europe, can also share their expertise, know-how and best practices to combat corruption in other developed nations and also in developing countries. This is a global challenge that is both local and transnational in nature that needs to be tackled in a more cooperative manner. For this, stronger and better organised civil societies are needed.

Finally, it is important to assure a continued but controlled flow of migration, which is needed by developed societies that are getting older but is also beneficial for host countries. As Milanović (2016) explains, remittances by immigrants have been a very important contribution to the development of the countries of origin of foreign workers and there should be guarantees that this will continue to be so. Furthermore, many migrants eventually return to their countries of origin with more experience, skills and savings, which is also positive. At the same time, migration is also beneficial for the host nations because, as Hausmann has suggested, a multicultural society with different backgrounds, life-styles and mindsets fosters research and knowledge and pushes the boundaries of innovation. It is not a coincidence that Silicon Valley, one of the world's most ethnically diverse locations, is producing so much cutting-edge companies and that most of them have foreigners as their CEOs.

#### *Inclusive technological progress*

Technology is a source of growth. The G20's 'Blueprint for innovative growth' (G20, 2016) should continue to be the basis for furthering 'the importance of inclusiveness to eradicate extreme poverty, reduce inequality and social exclusion and to bridge the digital divide'. This should be part of the concept of 'technological justice' (Ortega & Andrés, 2017).

Pushing for a plan for the digitalisation and technologisation of Africa and the poorer parts of Asia, with public-private compacts such as the Marshall Plan with Africa proposed by the German government (German Federal Ministry for Economic Cooperation and Development, 2016), is the way forwards. The demographic evolution of Europe and Africa show that if Africa does not continue developing in a sustainable manner, hundreds of millions of Africans will want to move north to Europe to have a better life. The flows should not be halted completely, but they do need to be managed and regulated. Therefore, the development of Africa is a key issue for Europe.

This long-term vision and strategy on how to manage the future development of Africa and Europe needs to build on the EU's D4D programme. Such a scheme should also be tried at a more global level. The aim should be to avoid a digital gap by connecting people of all ages and conditions, including gender, and by utilising these new technologies and digital capacities both locally and globally.



## Concluding remarks

Globalisation has lost legitimacy in advanced countries and risks losing legitimacy also in emerging and developing countries if it fails to deliver growth and prosperity at a sufficiently rapid pace. This is perhaps the greatest challenge for political elites, both at the national level and at the G20.

This paper has argued that there is an urgent need to design policies to reverse the growing discontent associated with liberal market policies. It is also crucial to reduce the growing anxiety of large sectors of the population with the rapid pace of technological change and its impact on employment and income distribution.

This policy paper has presented a number of proposals to face these challenges. However, it would be necessary to study in greater detail the impact of automation on employment in different parts of the world. Subsequently, efforts need to be concentrated on how to develop a welfare function of ‘technology for all’ through greater international cooperation. This will need resources, including funding for better education, re-training, means-tested and incentive-based support and even for basic incomes. The only way to gather these funds is to introduce measures against fiscal evasion and elusion. While the new welfare models need to be more transparent, more efficient and less bureaucratic, it is also true that they need to be better funded to provide the public services that modern societies demand. Only in this way can a future clash be avoided between the relatively declining middle classes of the developed economies and the ascending ones of the emerging economies.

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